JUN 3 1925
SUPREME COURT U.S.

In the Supreme Court
OF THE
United States

268

OCTOBER TERM, 1924

LUCY WARD STEBBINS and FRANK J. HUSLEY, as executrix and executor of the will of Henrietta Pierce Watkinson, deceased,

Plaintiffs in Error,

vs.

No. 287

RAY L. RILEY, Controller of the State of California,

Defendant in Error.

PETITION FOR A REHEARING ON BEHALF OF PLAINTIFFS IN ERROR.

CAREY VAN FLEET,
Crocker Building, San Francisco,
JOSEPH G. DE TOMBE,
Crocker Building, San Francisco,
MAURICE E. HARRISON,
Crocker Building, San Francisco,
Attorneys for Plaintiffs in Error.

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1924

No. 227

LUCY WARD STEBBINS and FRANK J. HURLEY, as executrix and executor of the will of Henrietta Pierce Watkinson, deceased,
Plaintiffs in Error,

vs.

RAY L. RILEY, Controller of the State of California,
Defendant in Error.

PETITION FOR A REHEARING ON BEHALF OF PLAINTIFFS IN ERROR.

To the Honorable William Howard Taft, Chief Justice of the United States, and the Associate Justices of the Supreme Court of the United States:

We respectfully present this petition for rehearing of the judgment in the above entitled cause:

In one of the concluding paragraphs (6) of the Opinion in the above case, the court, speaking through Mr. Justice Stone, states the position of plaintiffs in error, as follows:

> "The plaintiffs in error base their argument that this is a denial of the equal protection of the laws on the assumption that the California inheritance tax must be dealt with exclusively as a tax upon succession, and that since the privilege of receiving residuary legacies of like amounts by persons of like relationship is subjected to unequal taxation, the inequality depending upon the size of the estate from which the legacy is received, there is an arbitrary discrimination and a denial of the equal protection of the laws."

This is a very fair, clear and distinct statement of the position of plaintiffs in error. In answer thereto, however, the court, speaking through Mr. Justice Stone, does not seem to attempt to justify such a discrimination between the residuary legatees within the same class upon the ground that there is a reasonable distinction by reason of the size of the estate, but bases its answer upon the proposition that, in so far as the rate of the tax paid by the legatee is determined by the amount paid the United States Government for an estate tax, to this extent the legatee pays a transfer tax as well as a legacy tax. To this extent the court seems to hold that the Inheritance Tax Act of 1917 is a transfer tax as well as a legacy tax, and the legatee pays both taxes. To this extent the court has placed its own construction upon the Inheritance Tax Law of Cali-

fornia for 1917, which of course it is privileged to do if there has been no construction thereof by the Supreme Court of California.

We maintain that such construction of this court is opposed:

First: To the express words of Subdivision 10 of Section 2;

Second: To the express provisions of the Inheritance Tax Law of 1917, as we shall point out; and

Third: To the settled law of California.

Such construction is opposed to the express terms of Subdivision 10 of Section 2, which reads as follows:

> "In determining the market value of *the property transferred*, no deduction shall be made for any inheritance tax or estate tax paid to the government of the United States."

Such construction is opposed to the express provisions of the Inheritance Tax Law of 1917, and the settled law of California. We may include both these propositions in one discussion. The settled law of California is found in:

Estate of Kennedy, 157 Cal. 517;
McDougall v. Low, 164 Cal. 110;
Estate of Miller, 184 Cal. 674, top page 682;
Estate of Potter, 188 Cal. 59.

We submit in this connection that this settled law was not modified by the opinion of our Supreme Court in *Stebbins v. Riley*, 191 Cal. 591, inasmuch as that decision was based upon the untrammelled

power of the state to tax, and not upon the nature of the tax.

The Inheritance Tax Act of 1905 is given careful consideration in the *Estate of Kennedy*, supra, to determine the nature of the tax. Practically the same provisions are in the act of 1917.

To make the controlling force of the decision obvious we mark the similarity in the following columns:

Construction given 1905 act in Estate of Kennedy.

(1) "The *all-important section* of the act in this controversy *is the section imposing the tax, the section declaring the property that shall be subject to the tax.* That is *Section* 1. So far as is material here, it provides:

"*All property which shall pass,* by will or by the intestate laws of this state, from any person who may die seized or possessed of the same while a resident of this state, * * * *to any person or persons,* or to any body politic or corporate, in trust or otherwise * * * *shall be and is subject to a tax* hereinafter provided for, * * * and such tax shall be and remain a *lien upon the property passed or transferred* until paid and the *person to whom the property passes or is trans-*

Construction of 1917 act in the light of the decisions in Estate of Kennedy and Estate of Miller.

(1) The *all-important* section of the act in this controversy *is the section imposing the tax, the section declaring the property that shall be subject to the tax.* That is *Section* 2. So far as is material here, it provides:

"A *tax shall be and is hereby imposed upon* the *transfer* of any *property* * * * *to persons,* institutions and corporations, * * * *said taxes to be upon the market value of such property at the rates hereinafter* prescribed.

Section 3 provides: "Such taxes shall be and remain a *lien upon the property* passed or transferred until paid * * * *and the person to whom the property passes or is transferred,* * * * shall be liable for any and all such taxes until

ferred * * * shall be liable for any and all such taxes until the same shall have been paid as hereinafter directed."

(157 Cal. 520.)

the same shall have been paid as hereinafter directed."

(2) "*Section* 2 prescribes the rates to be paid by different classes of persons 'entitled to *any beneficial interest in such property' when the property or interest 'so passed or transferred'* exceeds in value the exemption specified in *section* 4 and does not exceed in value twenty-five thousand dollars, while *section* 3 prescribes the rates for amounts in excess of twenty-five thousand dollars."

(157 Cal. 520.)

(2) *Section* 4 prescribes the rates to be paid by different classes of persons "entitled to *any beneficial interest in such property" when the property or interest "so passed or transferred"* exceeds in value the exemption specified in *section* 6 and does not exceed in value twenty-five thousand dollars, while *section* 5 prescribes the rates for amounts in excess of twenty-five thousand dollars.

(3) "Section 28 provides that the words 'estate' and 'property' as used in the act 'shall be taken to mean the real and personal property or interest therein of the testator, intestate, * * * *passing or transferred to individual legatees, devisees, heirs, next of kin, grantees, donees, vendees or successors'."

(157 Cal. p. 521.)

(3) Section 1, Subdivision 2, provides: "The words 'estate' and 'property' as used in this act shall be taken to mean the real and personal property or interest therein of the testator, intestate * * * *passing or transferred to individual legatees, devisees, heirs, next of kin, grantees, donees, or successors."*

(4) "By its terms the taxing act is limited to *such property as* 'shall pass * * *' from the deceased *to some other person."*

(157 Cal. 521.)

(4) The identical terms of the 1917 act similarly limits the tax to *property which "shall pass"* to a person, yet in the very teeth of the limi tation we have an attempt to tax property that never does or can pass to a person.

(5) "In one sense of the word, all of the property of deceased of which he died seized did 'pass * * *' to his sole devisee at the moment of his death, that is, she, by reason of the will, at once became vested with the title to the full property (*Brenham v. Story*, 39 Cal. 188), *but she took under the will 'subject to certain burdens*, as the payment of the debts of deceased, and the right of the Court to appropriate some portion of the estate for * * * (all purposes authorized and enjoined upon it by operation of law)'."

(157 Cal. 521-522.)

"The power of testamentary disposition of property * * * is not paramount, but is subordinate to the authority conferred upon the probate court to appropriate the property for '(other purposes)'. *And to the extent that this power is exercised by the probate court in any estate the legatees take no beneficial interest at all.*"

(157 Cal. 522.)

(5) The reasoning of the Supreme Court in *Estate of Kennedy* is amplified in decisions rendered subsequent thereto.

"This right to receive, which is taxed, is the right as it exists in concrete form, as when it has ripened, *and not as it exists in the abstract*, as *when it is no more than a mere possibility.* All citizens have the abstract right to receive property from the dead, but all citizens do not receive property from the dead. *A tax is not laid upon the abstract right to receive property* from the dead given to every citizen; but *the tax is laid only where the right* to receive has been transformed from an abstract right into a concrete right, *and property is actually transmitted* from the dead."

In re Inman's Estate, 199 Pac. p. 620 (Or.).

Of precisely similar provisos the Supreme Court of California said in

Estate of Miller, 184 Cal. at p. 682.

"It is the settled law of this state that the inheritance tax *is imposed upon the net clear market value of what the transferee receives, and to ascertain this, the value of what he does not* receive, in contemplation of law, *must be deducted from the value of*

(6) "It is clear that the widow *did not* receive any *beneficial interest in* * * * property ("diverted by operation of law") by reason of the will."

(157 Cal. 522.)

"It is recognized by this court and by the courts generally that a tax of this character is not a tax upon property as such, *but one upon the right of succession*, a tax *upon one for the privilege of succeeding to property.*"

(157 Cal. 523.)

Citing with approval from other courts, the Supreme Court further says:

"The tax was * * * on the net proceeds * * * to the persons upon whom it devolves.

"The * * * inheritance tax does not attach to the very articles of property of which the deceased died possessed. *It is imposed only on what remains* for distribution after expenses of administration, debts, *and rightful claims of third parties are paid or provided for. It is on the net successions to the beneficiaries.*"

(157 Cal. 524.)

what the decedent left. The application of this *principle plainly* requires the deduction of the federal estate tax."

(6) It is equally clear that residuary legatees *do not receive any* beneficial interest in property lawfully diverted to pay federal estate taxes. It is also certain that the provisions of the statute *imposing* the tax upon the *beneficial interest received only* are identical in the 1917 act with those contained in the 1905 act upon which the opinion set out in the opposite column is based. Every excerpt of the Kennedy decision is therefore applicable and of controlling force here. No part of the money paid the federal government as taxes remains for distribution.

The federal tax is a rightful claim of a third party that must be satisfied before the legatee can take any part of his legacy.

"It comes into existence before and independent of the receipt of property by the legatee."

Edward v. Slocum, 264 U. S. 61, 62.

Note: The matter in parentheses is our own.

(7) "If no transfer is effected, because it turns out that there is no property to transfer, no tax can be collected."

(157 Cal. 525.)

(7) No transfer to a legatee is effected of moneys diverted to the federal government. Hence no tax is levied thereon.

(8) *"The provisions of our tax act clearly show that the tax imposed thereby is one solely upon the devisee, legatee or heir.* It would appear to be a most absurd and inequitable provision that imposed a tax on one for the privilege of succeeding as heir, devisee, or legatee to certain property of the decedent, when the very property to which he is so held to succeed is *lawfully diverted by the probate court to other purposes and never can be distributed to him."*

(157 Cal. 526.)

(8) The provisions of the 1917 act impose the tax in the same identical language, and as stated by State Controller Chambers:

"It is neither fair nor equitable" * * * "to tax a man for something he does not get. He receives an inheritance diminished to the extent of the taxes he is compelled to pay by law, yet is compelled to pay an inheritance tax on the false assumption that he receives the full amount undiminished * * * It is not right or just to tax a party for property he does not receive, but on the contrary is diverted from him by operation of law."

(Report of State Controller, 1918-20, page 221.)

We are unable to find where this settled law has been disturbed by the Supreme Court of California in *Stebbins v. Riley.* The language there dealt wholly with the power of the state, and not with the nature of the tax, the court pointing out that the change in the act of 1917 had to do with the "policy of the state with respect to the deduction

to be made on account of the federal inheritance taxes imposed or paid prior to the report of the State Inheritance Tax Appraiser to the court thereof." (Trans. 42.)

It is difficult to escape, therefore, the conclusion that the legislature arbitrarily included within the value of the legatee's estate for the purpose of the tax, the amount paid to the United States Government. If it did so, it arbitrarily imposed a condition upon the legatee which led to the discriminations referred to and squarely admitted and faced by the opinion of this court. We submit, therefore, that the answer of this court to the contention of the plaintiffs in error set forth in the paragraph (6) of the opinion, just discussed, is not a complete answer.

In the next to the last paragraph (7) of the court's opinion, this court, speaking through Mr. Justice Stone, says:

> "There are two elements in every transfer of a decedent's estate: the one is the exercise of the legal power to transmit at death; the other is the privilege of succession. Each, as we have seen, is the subject of taxation. The incidents which attach to each, as we have observed, may be made the basis of classification. We can perceive no reason why both may not be made the basis of classification in a single taxing statute, so that the amount of tax which the legatee shall pay may be made to depend both on the total net amount of the decedent's estate passing under the inheritance and testamentary laws of the state, and the amount of the legacy to which the legatee succeeds under

those laws. Such a classification is not, on its face, unreasonable."

In other words, we understand this holding to be that the legatee may be compelled to pay a tax based not only on the value of the legacy which he receives, but also on the total amount of the decedent's estate passing under the law of the state. In other words, he pays not only a legacy tax, but a transfer tax. It is to be remembered, and this point was not emphasized in argument as it should have been, that the California Inheritance Tax Act is a graduated, progressive tax, and the rate is not a flat rate, but a rate graduated according to the value of the legacy transferred. It follows, therefore, that the legatee would be paying most of his tax, in many instances, upon the value of the net estate passing, but which he never received. This appears to be unreasonable, and although this court suggests that the case of *Knowlton v. Moore* (178 U. S. 41) was concerned with the construction of the Federal act, this very thing was condemned therein, on pages 76 and 77 thereof.

We have never been able to perceive the difference in principle between a Federal act, which sought to impose such a tax, and a State act, which should levy a tax upon a legacy not according to its own value, but according to the value of a wholly distinct and separate thing.

We have never been able to perceive the difference in principle between an excise tax or a regu-

latory tax or a property tax which sought to do these things under the Constitution of the United States.

The case at bar is more extreme than that put by Mr. Justice Stone in his opinion. He says the State may compel a legatee to pay a transfer tax as well as a legacy tax. But in the case at bar the transfer tax has been paid based upon the Government graduated rates. This amount is again added to the value of the legacy for taxable purposes. It is the same as if the State were to levy in the same statute a transfer tax and a legacy tax, imposing both upon the legatee. The transfer tax had been paid based upon graduated rates. The State then compelled the legatee to pay a graduated tax based on the value of his legacy plus the amount already paid the State as a transfer tax, thus pyramiding the legacy tax. So this is more than the payment of a transfer tax and a legacy tax in the first instance by the legatee.

In *Magoun v. Illinois Trust & Savings Bank*, 170 U. S. 283, of which so much has been said in this case, the court said, at p. 292:

> "The power of the states over successions may be as plenary in the abstract as appellee contends for, nevertheless it must be exerted within the limitations of that (Federal) Constitution. If the power of devise or of inheritance be a privilege, it must be conferred or regulated by equal laws."

This court further said, on page 300:

> "The tax is not on money; it is on the right to inherit; and hence a condition of inheritance, and it may be graded according to the *value* of that inheritance. The condition is not arbitrary because it is determined by *that value.* * * *"

Connolly v. Union Sewer Pipe Company, 184 U. S. 556-563.

In the latter case this court, speaking through Mr. Justice Harlan, said of *Magoun v. Illinois Trust & Savings Bank,* p. 561:

> "In Magoun v. Illinois Trust and Savings Bank we held that the progressive inheritance tax law of Illinois of June 15, 1895, was not in conflict with the Constitution of the United States by reason of the fact that the amount of the tax was determinable by valuation so that every person and corporation should pay in proportion to the value of his, her or its property inherited. The classification made by the statute was held not to be arbitrary by reason of the fact that inheritances were classified according to amount, and each class taxed at a different rate; for it was based upon principles of equality between the members of each distinct class. Such classification was held not to be inconsistent with the Fourteenth Amendment."

These are not the facts presented by the case at bar. By the court's own statement in this case, as we understand it, there is a discrimination *within* the class of residuary legatees. This discrimination still persists even if the California Act

were construed as partially imposing a transfer tax *paid by the legatee.*

It appears to us that the reasoning in the present case conflicts with the basic reasoning of this court speaking through Mr. Justice Holmes in *Lewellyn v. Frick,* No. 681, decided May 11, 1925, in which this court says:

> "The defendants in error say that if these policies are covered by the statute these sections show that the beneficiaries are taxed upon their own property, under the guise of a tax upon the transfer of his estate by Mr. Frick, and that this is taking their property without due process of law, citing *Matter of Pell,* 171 N. Y. 48, and other cases. In view of their liability the objection cannot be escaped by calling the reference to their receipts a mere measure of the transfer tax. The interest of the beneficiaries is established by statutes of the States controlling the insurance and is not disputed. It also is strongly urged that the tax would be a direct tax. In view of our conclusion it is not necessary to state the position of the defendants in error more in detail.
>
> We do not propose to discuss the limits of the powers of Congress in cases like the present. It is enough to point out that at least there would be a very serious question to be answered before Mrs. Frick and Miss Frick could be made to pay a tax on the transfer of his estate by Mr. Frick. There would be another if the provisions for the liability of beneficiaries were held to be separable, and it was proposed to make the estate pay a transfer tax for property that Mr. Frick did not transfer. Acts of Congress are to be construed, if possible, in such a way as to avoid grave doubts of this kind."

It would seem to us that such a situation arises when the legatee or heir is made to pay a tax upon property transferred to him, based, however, upon the total net amount of the estate which is not transferred to him, although, as we understand the opinion in the present case, this court considers such a tax reasonable.

A very late case on the construction of such an act as the California act with authorities compiled is *Jones v. Bauman,* 234 Pac. 953.

The court has given very full consideration to this matter, and we would hesitate to ask them to even read a petition for re-hearing, laboring as they are under immense burdens, unless we were still unconvinced that a sufficient answer has been made to our contentions.

Dated, San Francisco,
May 27, 1925.

Respectfully submitted,
CAREY VAN FLEET,
JOSEPH G. DE FOREST,
MAURICE E. HARRISON,
Attorneys for Plaintiffs in Error and Petitioners.

CERTIFICATE OF COUNSEL.

I hereby certify that the foregoing petition for a rehearing is not interposed to hinder, obstruct or delay the orderly procedure of the Supreme Court of the United States, and was prepared and is filed in good faith, and in my opinion is well founded in point of law.

Dated, San Francisco,
May 27, 1925.

CAREY VAN FLEET,
Attorney for Plaintiffs in Error and Petitioners.

Office Supreme Court,
FILED
FEB 25 1925
WM. R. STANSBURY
Clerk

No. 304.

OCTOBER TERM, 1924.

IN THE

SUPREME COURT OF THE UNITED STATES

LUCY WARD HENDERSON and FRANK J. HURLEY, executors, and executor of the will of Emerson Foster Watkinson, deceased,

Plaintiffs in Error,

vs.

RAY L. RILEY, Controller of the State of California,

Defendant in Error.

BRIEF FOR DEFENDANT IN ERROR.

Earle W. Evans,
Deputy Attorney General,
Attorney for Defendant in Error.

William H. Langer,
Dana H. Bissell,
Assistants Attorney General,
Of Counsel.

TOPICAL INDEX.

Page

STATEMENT OF THE CASE 1

THE CONTROLLER'S BIENNIAL REPORT 2

ARGUMENT—

1. The Challenged Provision is the Universally Accepted Statutory Enactment. Its Long and Continued Approval by the Federal Government and the Many States is Some Evidence that the Provision is not Unjust, Unequal, Oppressive or Arbitrary 3

2. The California "Inheritance Tax Act" is not Measured by the Value of the Interest Received by the Heir or Legatee, but the Standard of Measurement is Based on the Value of the Privilege to Transmit from the Dead to the Living 5

3. Legislative Authority is Unlimited in Burdening the Privilege of Inheritance. The Principle is Fundamental that the Rules of Transmission and Devolution of Property are Exclusively Within the Power and Control of the Individual Sovereign State 7

A. Not Every Charge Against an Estate is Deductible .. 8

4. Moneys Appropriated by the United States to Itself as Estate Taxes are not the First Charge Against an Estate and Their Withdrawal is not Prior to the Attachment of the State Inheritance Tax Lien 15

5. The Section is not Discriminatory for Every Class Receives Identical Treatment Under the Act and the Amount of the Tax is Measured Only by Factors Legitimately Included in the Taxing Statute 23

6. The Section does not Violate the Federal Constitutional Provision Guaranteeing all Persons Equal Protection of the Laws 25

7. The Section does not Violate the Inhibition of the Federal Constitution Against Depriving Persons of Property Without Due Process of Law, nor Does it Indirectly Attempt to Subject to State Taxation one of the Federal Revenues, nor Does it Interfere with the Power of Congress to Levy and Collect Taxes 28

8. The Section does not Violate the State Constitutional Inhibition Against Passing of Local or Special Laws Changing the Law of Descent or Succession 33

CONCLUSION 34

TABLE OF AUTHORITIES.

	Page
American Law Reports, Vol. 7, p. 685	5
American Law Reports, Vol. 16, p. 661	5
Banker's Trust Co. vs. State, 114 Atl. 108	33
Bowditch, Estate of Charlotte, 189 Cal. 377	15
Cahen vs. Brewster, 203 U. S. 543, 551	17
California Civil Code, Title VII, Part IV	33
Campbell vs. California, 200 U. S. 87, 94	30
Chandler vs. Kelsey, 205 U. S. 466, 482	12, 18
Constitution United States, 10th Amendment	22
Davidson vs. New Orleans, 96 U. S. 97	31
Estate of Charlotte Bowditch, 189 Cal. 377	15
Estate of Hite, 159 Cal. 392	8
Estate of Kennedy, 157 Cal. 523	5
Estate of Miller, 184 Cal. 674	5
Estate of Potter, 188 Cal. 55	15
Estate of Watkinson, 191 Cal. 597, 217 Pac. 1075	13, 15, 34
Estate of Wilmerding, 117 Cal. 281	14, 26, 28
Fountain, Inc., In Re A. E., 295 Fed. 874, 876	18
Gheens, Succession of, 88 So. (La.) 253	20
Giozza vs. Tiernan, 148 U. S. 657	31
Gleason & Otis, Inheritance Taxation, 1922 Ed. p. 376	19
Hazard vs. Bliss, 113 Atl. (R. I.) 469	20
Hite, Estate of, 159 Cal. 392	8
Inheritance Tax, Act of California (Chap. 589, Statutes 1917)	2
In Re A. E. Fountain, Inc., 295 Fed. 874, 876	18
In Re Frick's Estate, 121 Atl. (Pa.) 35, 39	34
In Re Josephine Penfold, 216 N. Y. 163, 170	10
In Re Sanford's Estate, 175 N. W. 506	34
Keeney vs. New York, 222 U. S. 525, 533	12, 31
Kennedy, Estate of, 157 Cal. 523	5
Kirkpatrick's Estate, 275 Pa. 271	32, 34
Knowlton vs. Moore, 178 U. S. 41	10
Lederer vs. Northern Trust Co., 262 Fed. 52, 54, 55	21
Louisville & Nashville R. R. Co. vs. Barber, etc., 197 U. S. 430	6
McCulloch vs. Maryland, 4 Wheat, 316, 4 L. Ed. 579	16
Magoun vs. Illinois Trust & Sav. Bk., 170 U. S. 283, 299	24, 26, 27, 28

TABLE OF AUTHORITIES—Continued.

	Page
Matter of Westurn, 152 N. Y. 93	8
Matter of William H. Penfold Estate, 216 N. Y. 171, 110 N. E. 499	9, 19
Maxwell vs. Edwards, 99 Atl. 138	29, 30
Miller, Estate of, 184 Cal. 674	5
New York Trust Co. vs. Eisner, 256 U. S. 345, 349	10, 25
Orr vs. Gilman, 183 U. S. 278, 288	12
Patterson vs. Colorado, 205 U. S. 454	6
Penfold Estate, Matter of William H., 216 N. Y. 171, 110 N. E. 499	9, 19
Penfold, In Re Josephine, 216 N. Y. 163, 170	10
Potter, Estate of, 188 Cal. 55	15
Re Sherman, 222 N. Y. 540, Aff. 179 App. Div. 497	19
Snyder vs. Bettman, 190 U. S. 1035	19
Stone, Harlan F., Opinion of	35
Stone vs. Elliott, 182 Ind. 454, 462, 463	7
Succession of Gheens, 88 So. (La.) 253	20
United vs. Fox, 94 U. S. 315, 320	34
United States vs. Perkins, 163 U. S. 625	28, 30
Walker vs. People, 8 A. L. R. 855	14
Wardell vs. Blum, 276 Fed. 226, 227	35
Watkinson, Estate of, 191 Cal. 597, 217 Pac. 1075	13, 15, 34
Westurn, Matter of, 152 N. Y. 93	8
Wheeler vs. New York, 233 U. S. 438	6
Wilmerding, Estate of, 117 Cal. 281	14, 26, 28

IN THE

SUPREME COURT

OF THE

UNITED STATES

OCTOBER TERM, 1924.

No. 227.

LUCY WARD STEBBINS and FRANK J. HURLEY, as executrix and executor of the will of Henrietta Pierce Watkinson, deceased,

Plaintiffs in Error,

vs.

RAY L. RILEY, Controller of the State of California,

Defendant in Error.

BRIEF FOR DEFENDANT IN ERROR.

STATEMENT OF THE CASE.

The question presented on this writ of error to the Supreme Court of California involves the deduction of the federal estate tax in arriving at the clear market value of a California estate.

Which of the two taxes is paramount, federal or state; which has priority, the time of their attachment to an estate, are important factors to determine in reaching a solution.

From 1917 to 1921 the California Inheritance Tax Act carried a provision expressly disallowing the federal estate tax as a deduction:

> "In determining the market value of the property transferred, no deduction shall be made for any inheritance tax or estate tax paid to the government of the United States."
>
> Subdivision (10) of section 2 of the 1917 Inheritance Tax Act of California (chapter 589, Stats. 1917).

Henrietta Pierce Watkinson died, testate, on August 7, 1920. In computing the inheritance tax due the State of California the inheritance tax appraiser in his report made no deduction on account of moneys paid the United States as a federal estate tax.

Decedent in her will left a residuary estate of more than $1,000,000; the total death duties of both the federal and state governments were less than $400,000. (Record pp. 2 to 4.)

The Controller's Biennial Report.

The materiality of a recital of a portion of a report of a former California State Controller, rests with plaintiffs in error (counsel's brief p. 5). The theme of their brief is woven around certain selected sentences from this extrajudicial document, which was not given consideration in this proceeding by the courts of this state.

Notwithstanding a former Controller's statements the provision in question remained in our Inheritance

Tax Act for a period of four years, although our legislature met biennially during all of which time he was Controller. (And at present like provisions may be found in inheritance tax statutes in more than a dozen sister states.) Hundreds of estates were subjected to tax, without their objecting, and without the allowance of the federal estate tax as a deduction.

Plaintiffs in error misstate the facts when they say:

> "It was agreed by all persons concerned therefore, including the officers of the State of California, and the attorneys of the Controller in the present action that * * * was unjust and inequitable."

The present inheritance tax attorney was not the author of the quoted portion from the Controller's report and played no part in the preparation thereof. The statement of the Controller is entitled to the same weight as any argument presented by a layman before legislative committees for the purpose of securing amendments to a legislative enactment. For the Controller submitting this report was not an attorney.

ARGUMENT.

The challenged provision is the universally accepted statutory enactment. Its long and continued approval by the federal government and the many states is some evidence that the provision is not unjust, unequal, oppressive or arbitrary.

The legislatures of the following states have written into their inheritance tax acts, provisions dis-

allowing the federal estate tax as a deduction in similar language to that found in the California act: South Dakota, Montana, Iowa, Louisiana, New York, Rhode Island, Wisconsin, Pennsylvania and Michigan. In the year 1919 the federal estate tax act was amended, disallowing as a deduction taxes paid other sovereigns.

Plaintiffs in error insist that the California Inheritance Tax Act is "unjust and inequitable" and the provision disallowing the deduction capricious and arbitrary. It is not for us to extol the acumen of a California legislature, but we do wish to speak in the highest terms of the legislatures of the above noted states, as well as of the congress of the United States, all of which have wisely and well written into their various death duty acts like provisions disallowing the deduction. The Supreme Court of California, in the forty-odd times it has been called to pass upon the "Inheritance Tax Act," has turned a deaf ear to those who challenged its provisions as arbitrary or unconstitutional, having in each instance judicially construed the act to arrive at the legislative intent.

Further, the courts of last resort in these various states have all sustained this particular character of legislation as a just and lawful exercise of the legislative function. The cases decided throughout the United States prior to 1924 touching upon the deduction of the federal estate tax or the deduction of state inheritance taxes are collected in volume 7, American

Law Reports, beginning at page 685, and volume 16, American Law Reports, beginning at page 661.

The California "Inheritance Tax Act" is not measured by the value of the interest received by the heir or legatee, but the standard of measurement is based on the value of the privilege to transmit from the dead to the living.

Plaintiffs in error lay special emphasis on the fact that there is language in *Estate of Miller,* 184 Cal. 674, to the effect that the California Supreme Court, in passing upon a matter arising before the amendment disallowing the deduction was written into the act, indicated that the Inheritance Tax Act of California was a legacy tax or a tax upon what the transferee received. It was to fortify the Inheritance Tax Act and to avoid the effect of just such a decision as the court rendered in the *Miller* case that prompted the amendment in question.

The *Miller* case construed the "general provisions" of the then "Inheritance Tax Act," while the court in the instant case has for consideration an amendment to the act which carried a "special provision" added for a specific purpose, *i. e.* to disallow the federal tax as a deduction.

Plaintiffs in error in making such elaborate use of the *Estate of Miller* and *Estate of Kennedy,* 157, Cal. 523, infer that a citizen possesses a constitutional right to have a general proposition of law once adopted, remain unchanged, and that a legislative

declaration to alter an established rule coupled with a decision of the court construing the more recent enactment is a violation of some constitutional right. This honorable court, however, can not be interested in the wisdom of a state legislature in amending its laws, nor the reason adopted by its highest court in construing a law, for decisions of a state court upon such a question of law, however wrong and however contrary to previous decisions, are not an infringement of the fourteenth amendment.

"But we are bound by the construction given to the New York statutes by the New York courts."
Wheeler vs. *New York*, 233 U. S. 438.

"It would be an extraordinary deduction from the fourteenth amendment to deny the power of a state to adopt the usages and views of business men in a statute on the ground that it was depriving them of their property without due process of law. The necessity of caution in cutting down the power of taxation on the strength of the fourteenth amendment often has been referred to."
Louisville & Nashville R. R. Co. vs. *Barber Asphalt Paving Co.*, 197 U. S. 430, 434.

"Unless we are bound by authority, we think the statute, so far as we now are concerned with it, plainly within the power of the state to pass."
Louisville & Nashville R. R. Co., vs. *Barber Asphalt Paving Co.*, 197 U. S. 430, 439.
Patterson vs. *Colorado*, 205 U. S. 454.

"The right to inherit is not a natural right. It does not inhere in any one. It is a creature of the

law, and its existence and limitations must be found in the law. (Citing long list of cases.) Ownership does not extend beyond the life of the owner. The right to transmit title to property to another at the end of the life of the owner did not exist always; it was created by law, upon considerations of public policy, and the law-making power has always retained and still has the authority to designate who shall inherit."

Stone vs. *Elliott,* 182 Ind. 454, 462, 463.

In this case of the *Estate* of *Watkinson,* 191 Cal. 597, the Supreme Court of California said:

"The right of inheritance, * * * as well as the right of testamentary disposition, are entirely matters of statutory enactment, and within the control of the legislature, as it is only by virtue of the statute that the heir is entitled to receive any of his ancestor's estate, * * *."

Legislative authority is unlimited in burdening the privilege of inheritance. The principle is fundamental that the rules of transmission and devolution of property are exclusively within the power and control of the individual sovereign state.

The 1917 California "Inheritance Tax Act" is a charge, not based on the amount ultimately received by the beneficiary, for the language of the act provides that not only the value of the estate must be taken as of date of death, but that the tax shall attach and be computed as of that date and be a liens as of that time.

Therefore, NOT EVERY CHARGE AGAINST AN ESTATE IS DEDUCTIBLE. A beneficiary seldom pays a tax upon the exact amount of property distributed to him; for example, property destroyed by fire subsequent to the date of decedent's death and prior to distribution is taxed at its full market value, although at date of distribution its value has been diminished or entirely destroyed. And property stolen or embezzled by an administrator and never distributed is nevertheless taxed to the one to whom it should go at its full market value. *Estate of Hite,* 159 Cal. 392.

Expenses sustained by an estate through useless, wilful and extravagant will contests and litigation are not deducted from the amount of taxable assets (*Matter of Westurn,* 152 N. Y. 93), and under the present inheritance tax act of California only the "ordinary expenses of administration" are recognized deductions.

The authorities are fully in accord that losses to an estate before distribution by fire, earthquake, flood or other act of God, or theft, embezzlement or expensive litigation which caused diversion by act of man is not to be considered as a deduction or diminution of the estate for inheritance tax purposes.

So, we find in the case at bar the property is diverted solely by reason of the act of the federal government, from which government the right to transmit property is not received, and therefore we respectfully urge that when the legislature has

spoken in no uncertain terms as to how such diversion should be treated for taxable purposes these rights should not be defeated by an act of the federal government any more than the act of God or the act of man.

"It is not every legitimate expenditure by an executor or administrator which is to be deducted as an expense of administration in fixing the sum upon which the transfer tax is to be computed. For instance, the transfer tax paid by the administrator in order to effect the transfer of stock in a corporation of another state, which payment is necessary in order to render the stock effective as an asset of the estate, is not to be allowed as an expense of administration in fixing the transfer tax, although it is payable out of the estate upon a final settlement as a disbursement."

Matter of William H. Penfold Estate, 216 N. Y. 171, 110 N. E. 499.

"The necessity for certainty and uniformity in the time when the tax accrues and becomes due and payable required the adoption by the legislature of a fixed and arbitrary rule. * * * If, as claimed by the appellant, the tax is imposed upon the several bequests as choses in action, the value of which can only be determined at some date subsequent to the death of the decedent when on an accounting by the personal representative or otherwise the bequest is received in possession, it would lead to such confusion and uncertainty as to make the collection of the tax unnecessarily burdensome and at least to some extent impracticable."

In re Josephine Penfold, deceased, 216 N. Y. 163, 170.

Our tax is based on the value of the privilege of transmitting property, or rather, upon the vehicle carrying the privilege, a will in the instant case. The charge for this privilege is computed upon the value of the estate owned by the decedent. This is unquestionably true, for our inheritance tax act, section 2 thereof, reads:

> "(a) A tax shall be, and is, hereby imposed upon the transfer of any property * * *,
> (1) 'When the transfer is by will.' "

The California legislature, in expressly failing to allow the federal estate tax as a deduction, indicated that the charge for inheritance should be based on the estate as it existed at time of death, irrespective of the quantum of the bequest ultimately received by the beneficiary. The intention of the California legislature to have its tax attach to an estate prior to the lien of the federal estate tax could not have been expressed in clearer language, nor can the intention of the legislature to exact the tax for the privilege *given to the testator by the sovereign to transmit property be questioned.*

This honorable court in its opinion in *New York Trust Company* vs. *Eisner,* 256 U. S. 345, 349, accepted the language of *Knowlton* vs. *Moore,* 178 U. S. 41, "The power to transmit or the transmission or receipt of property by death" is the privilege upon which

the tax is exacted. "For if the tax attaches to the estate before distribution—if it is a tax on the right to transmit, or on the transmission at its beginning, obviously it attaches to the whole estate except so far as the statute sets a limit."

The principle underlying the theory of inheritance taxation is one of "give and take." In the first instance, we have the state providing a vehicle by means of which disposition of an estate may be made. But in consideration of the use of this right, and it may even be stated so broadly as to say that it is by way of compensation therefor, we have the state exacting a fee, commonly known as a tax or excise, for the right or privilege. The state's charge for this privilege of transmitting is known by the distributor.

It is the privilege, then, which is to be valued and appraised for inheritance tax purposes, and with a view to expressing itself in this particular connection, the legislature has decreed that the value of the privilege, which it has granted and seen fit to tax, shall be determined without regard to the tax which is paid the federal government.

The court of appeal overruled the proposition that the transfer tax in question was a tax upon property and not upon the right of succession, and held that when David Dows, senior, devised this property to the appointees under the will of his son he necessarily subjected it to the charge that the state might impose on the privilege accorded to the *son of making a will*

and that the charge is the same in character as if it had been laid on the inheritance of the estate of the son himself, that is, for the privilege of succeeding to the property under a will.

Orr vs. *Gilman*, 183 U. S. 278, 288.

"They argue that inheritance taxes have been sustained on the ground (*United States* vs. *Perkins*, 163 U. S. 625) that no one has the natural right to acquire property by will or descent, and if the state permits such acquisition, it may require the payment of a tax as a condition precedent to the right of *using* that *privilege*.

There is no natural right to create artificial and technical estates with limitations over, nor have the remaindermen any more right to succeed to the possession of property under such deeds than legatees and devisees under a will. *The privilege of acquiring property* by such an instrument is as much dependent upon the law as that of acquiring property by inheritance."

Keeney vs. *New York*, 222 U. S. 525, 533.

"The ground upon which this tax is imposed is, I repeat, the right of the state to regulate or, if it sees fit, to destroy inheritances. If it might have not appropriated the whole, it can not appropriate any part by the law before us. And I also repeat that it has no bearing upon the matter that by a different law the state might have derived an equal revenue from these donees in the form of a tax."

Chandler vs. *Kelsey*, 205 U. S. 466, 482. Dissenting opinion, Mr. Justice Holmes, with whom Mr. Justice Moody concurred.

Plaintiffs in error contend that the rights of heirs, legatees and devisees in California become vested immediately upon the death of the testator or intestate decedent. As to intestacy, this is undoubtedly correct, but in all events the vesting is subject to all claims against the estate and all liens created by the decedent or attaching to the estate by operation of law. Therefore the interests of the heirs, legatees or devisees are determined only at distribution, when it has been shown that the charges against the estate have been satisfied. And in the instant case, the rights of the residuary legatees, more particularly their interest or their quantum of estate, could only be determined after the payment of the federal estate tax and all other just, fixed charges on the property of decedent.

> "In this view of the provision of the statute under consideration it can not be held violative of the terms of the federal constitution, since the devisee or legatee of the estate affected by this provision does not become entitled to his portion of the property of the said estate until it has already been burdened with his inheritance tax and hence by no part of said scheme of taxation can he be held to be deprived of property without due process of law."
>
> *Estate of Watkinson,* 217 Pac. (Cal.) 1075.

The great weight of authority therefore holds that the right of inheritance, including the designation of heirs and the proportions which the several heirs

shall receive, as well as the rights of testamentary disposition, are entirely matters of statutory enactment, and within the control of the legislature, as it is only by virtue of the statute that the heir is entitled to receive any of his ancestor's estate or that the ancestor can divert his estate from the heir.

The nature of the tax is pointed out in *Walker* vs. *People,* 8 A. L. R. 855, "The succession and not the thing inherited is the subject of a succession tax."

Through a long list of decisions over a quarter of a century the Supreme Court of California without variance has held the California inheritance tax was a charge on the vehicle used to transfer or the exercise of the right to transfer the title at death.

> "The right of inheritance, including the designation of heirs and the proportions which the several heirs shall receive, as well as the right of testamentary disposition, are entirely matters of statutory enactment, and within the control of the legislature. As it is only by virtue of the statute that the heir is entitled to receive any of his ancestor's estate, or that the ancestor can divert his estate from the heir, the same authority which confers this privilege may attach to it the condition that a portion of the estate so received shall be contributed to the state, and the portion thus to be contributed is peculiarly within the legislative discretion."
>
> *Estate of Wilmerding,* 117 Cal. 281.

> "The legislature may place any condition or burden upon the right to inherit property."

Estate of Potter, 188 Cal. 55;
Estate of Watkinson, supra.

"In other words, the tax is imposed and is sustainable upon the theory that a state which confers the privilege of succeeding to property may attach thereto the condition that a portion of the property shall be contributed to that state."
Estate of Charlotte Bowditch, 189 Cal. 377.

Moneys appropriated by the United States to itself as estate taxes are not the first charge against an estate and their withdrawal is not prior to the attachment of the state inheritance tax lien.

It is apparent from the long list of authorities that the tax is on the privilege of transmission and there is in California no constitutional prohibition against the taxing of a civil right or privilege. It is fundamental that California could abolish the right of testamentary disposition, as well as that of inheritance, over all property within the state; take away the California legislation and the privilege now taxed by congress does not exist. Therefore, the State of California, having the right to say when and under what circumstances an estate shall pass, there is no transfer, and therefore nothing upon which the federal tax can operate, until the state lays down the rules and conditions of inheritance.

It is logical then to conclude that when the legislature imposes a tax on the right of inheritance, the state is asserting its ownership to a portion of the

property of the ancestor, title to which vests in the state at death. The legislature, having the power to impose a tax upon the passing of property from the dead to the living, had the exclusive power of determining the method by which the amount of the tax should be ascertained.

> "The federal power to tax on the occasion of transmission of property on death must be governed by the state's exclusive power of regulation of that subject, and its full execution."
>
> *McCulloch* vs. *Maryland,* 4 Wheat. 316, 4 L. ed. 579.

Both sovereigns can insist upon an exaction on the whole estate of a decedent for the privilege of its transfer. Their laws are of equal solemnity and attach to the state simultaneously. The federal government, however, can not prescribe rules of succession of estates or in any wise usurp any of these powers residing in the various states. When the State of California said that the federal estate tax should not be deducted in arriving at the clear market value of an estate, it prescribed a condition of succession which must be complied with before the succession laws of California are available to a beneficiary. The federal government can likewise in its power place burdens on the privilege of succession granted by the state, within well defined limits, however, but not broad and limitless as can the states.

> "IN OTHER WORDS, WE DEFINED THE NATURE OF THE TAX: WE DID NOT PRESCRIBE THE TIME OF ITS IMPOSITION.

TO HAVE DONE THE LATTER WOULD HAVE BEEN TO PRESCRIBE A RULE OF SUCCESSION OF ESTATES AND USURP A POWER WE DID NOT AND DO NOT POSSESS. THERE IS NOTHING, THEREFORE, IN THOSE CASES WHICH RESTRAINS THE POWER OF THE STATE AS TO THE TIME OF THE IMPOSITION OF THE TAX. IT MAY SELECT THE MOMENT OF DEATH, OR IT MAY EXERCISE ITS POWER DURING ANY OF THE TIME IT HOLDS THE PROPERTY FROM THE LEGATEE. 'IT IS NOT,' WE SAID IN THE PERKINS CASE, 'UNTIL IT HAS YIELDED ITS CONTRIBUTION TO THE STATE THAT IT BECOMES THE PROPERTY OF THE LEGATEE.' "

Cahen vs. *Brewster,* 203 U. S. 543, 551.

In bestowing this right California has justly attached some burden, one being that in cases of priority between the federal government and the sovereign state, the state granting the privilege shall stand on the same ground as the federal government.

In the dissenting opinion of Mr. Justice Holmes, with whom was Mr. Justice Moody, we find the following:

"A state succession tax stands on different grounds from a similar tax by the United States or a general state tax upon transfers. It is more unlimited in its possible extent, if not altogether unlimited, and therefore it is necessary that the boundaries of the power to levy such taxes should be accurately understood and defined.

I always have believed that a state inheritance tax was an exercise of the power of regulating the devolution of property, by inheritance or will upon the death of the owner,—a power which belongs to the states; and I have been fortified in my belief by the utterances of this court from the time of Chief Justice Taney to the present day. (Citing long list of cases.) *For that reason the power is more unlimited than the power of a state to tax transfers generally, or the power of the United States to levy an inheritance tax."*
Chandler vs. *Kelsey,* 205 U. S. 466, 479.

"Of course, any tax which is a lien would necessarily precede any other claim, whether by virtue of the taxing power or otherwise, which was not a prior lien. * * * Whatever may be the proper construction of this act, the Commissioner of Internal Revenue and the New York State Tax Commission have approved of sharing pro rata in the fund, where there is not sufficient to pay the taxes due to both. I am filing herein letters, or copies thereof, indicating their desire to take this position. It is evident that such a practical adjustment is much wiser than a contest between the two sovereignties in the imposition of statutory liens. I shall therefore not attempt to decide whether the state has under the particular statute in question a lien prior to the federal government, but shall order the state and federal taxes paid *pari passu."*
In re A. E. Fountain, Inc., 295 Fed. 874, 876.

"In New York the inheritance tax imposed by another state is not allowed as a deduction, and

this rule was impliedly affirmed by the Supreme Court of the United States, which dismissed the appeal of the executor."

Matter of W. H. Penfold, 216 N. Y. 171; 110 N. E. 499.

Gleason & Otis Text Book on Inheritance Taxation, 1922 Ed. p. 376.

We find in the dissenting opinion of Mr. Justice White, in *Snyder* vs. *Bettman,* 190 U. S. 1035, with whom concurred Mr. Chief Justice Fuller and Mr. Justice Peckham, an axiomatic legal principle, not inconsistent with the main opinion in the case, which is the settled rule concerning the regulation of succession and the priority of attachment of the federal and state inheritance tax liens.

"The United States not possessing, as the states do, the right to regulate successions, when the United States calls into play its taxing power over the subject of the passage or receipt of property by death, the extent of its authority is to be measured solely by the scope of the taxing power conferred by the constitution."

To the same effect is the New York rule.

"Congress may impose an excise tax, such as the federal estate tax, and the state may impose a like local tax, but congress can not abridge the power of the state to tax a privilege the state confers by act of its legislature. Such a construction will not be given unless the proper construction of the local act imperatively demands it."

Re Sherman, 222 N. Y. 540, affirmed 179 App. Div. 497.

"These opinions should have persuasive force with us only in the event that we find a like legislative intent in the Rhode Island statute. We say the laws of Rhode Island because it is the law of the state and not the federal law which limits and regulates the transfer of a decedent's property."

Hazard vs. *Bliss,* 113 Atl. (R. I.) 469.

"In determining this question (Is the federal estate tax a proper deduction?) we begin with the fundamental principle that the rule of transmission and devolution of property are exclusively within the power and control of the individual sovereign state.

If it sees fit, it may ordain that no one shall inherit the estate of a deceased person, and that the entirety shall inure to the public fisc, in which event the national government would be powerless to impose any tax or burden thereon, for such an imposition would be an encroachment upon state sovereignty, not authorized by the powers delegated under the federal constitution."

Succession of Gheens, 88 So. (La.) 253.

"The nature of collateral inheritance taxes has been the subject of many decisions, both federal and state. The general principle of such of them as are termed legacy and succession taxes, when not otherwise affected by statutory provisions, is that the tax is upon the legacy before it reaches the hands of the legatee, whose property it becomes only after it has yielded its contribution to the state and after it has suffered a diminution

to the amount of the tax in return for the legislature's assent to the bequest. (Citing cases.) But in looking for the nature of the collateral inheritance tax under consideration, it is not necessary to seek light from statutes and decisions of other states, for the act shows its nature by its own clear expressions aided by interpretations repeatedly made by the Supreme Court of Pennsylvania.

In using the words 'all estates' shall be subject to the tax, the Supreme Court of Pennsylvania has held that the legislature contemplated the property of the decedent, not the interest therein of the legatee or distributee, *Del Buto's Estate,* 45 Leg. Int. 474; *Howell's Estate,* 147 Pa. 164, 23 Atl. 403; that the tax is imposed only once, and that is before the legacy has reached the legatee and before it has become his property; that it must be retained and paid by the executor or administrator who has the decedent's property in charge; that which the legatee really receives is not taxed at all; his property is that which is left after the tax has been taken off."

Lederer vs. *Northern Trust Co.,* 262 Fed. 52, 54, 55.

We have no quarrel with the proposition that the federal government, with its delegated powers from the sovereign states, may impose certain conditions upon the succession to property, but we insist that the right of the federal government to foreclose the sovereign state by the prior attachment of their tax to an estate can only be maintained by an express constitutional grant, which delegation has never been made by the states.

"The powers not delegated to the United States by the constitution, nor prohibited by it to the states, are reserved to the states, respectively, or to the people."

Tenth amendment to the constitution of the United States.

The State of California, by virtue of its paramount power and authority to grant succession to property, seizes upon a part of the estate and appropriates that part to its use immediately upon death. The right of the state comes into existence before, and is independent of, the receipt of the property by the legatee; his legacy is not taxed at all, the property he receives is the amount left after the tax has been satisfied.

Opposing counsel is in error in urging that the federal tax has a priority and is paramount, particularly when the state in its laws has expressly designated the contrary. Any attempt of the federal government to have its tax supersede the state tax and to subject an estate to a federal tax lien first and to the exclusion of a state inheritance tax charge would indeed be an unlawful interference with the laws of descent and distribution and an invasion of state sovereignty. Where under the constitution the right to grant a privilege is concurrent in the federal and state government, the rule may be otherwise. The foundation of and authority to levy the federal estate tax is a state-given privilege, therefore the federal tax is limited by any condition or reservation found in the law creating the privilege.

Our tax is not imposed upon the exercise of the privilege to receive property. The state-granted right to Helen Pierce Watkinson to make a will by which her estate could be transmitted as she wished, is the privilege upon which the charge is made. The receipt of the property by the beneficiary is a mere incident and only naturally follows.

No more can be said for the federal estate tax than that it is of equal solemnity with the state inheritance tax. In the event of the loss or destruction of an estate's assets during administration, thereby leaving in the hands of the executor insufficient funds to meet both taxes computed as of death, would the federal tax be first satisfied and then the state tax be satisfied only to the extent of the remaining property? Or would not the state by reason of its control of succession have the prior lien? The most favorable position that the federal government could expect would be a proration of the taxes, a plan judicially sanctioned in case of an insolvent debtor owing taxes to a state, a county and a city.

The section is not discriminatory for every class receives identical treatment under the act and the amount of the tax is measured only by factors legitimately included in the taxing statute.

Plaintiffs in error point out in their brief at page 38, by means of certain illustrations, the inequalities which might occur under the California Inheritance Tax Act. They do not, however, urge that these

inequalities could exist in the estate of the within decedent, as in the instant estate the residue thereof devised by testator to eight persons amounts to upward of $1,000,000 while the total tax burdens on the estate to the State of California and the federal government aggregate approximately $375,000. It is true that a residuary legatee might inherit a liability, should he fail to renounce the legacy, by reason of inheritance tax charges on an estate, but this could not be done without the express and intentional declarations of the testator. In case of an intestacy this could not happen. It can not seriously be urged that there is any inequality in the treatment by California of residuary legatees, as we treat them all similarly situated in the same manner.

> "There are four classes created, and manifestly there is equality between the members of each class. Inequality is only found by comparing the members of one class with those of another. It is illustrated by appellant as follows: One who receives a legacy of $10,000 pays 3 per cent, or $300, thus receiving $9,700 net; while one receiving a legacy of $10,001 pays 4 per cent on the whole amount, or $400.04, thus receiving $9,600.96, or $99.04 less than the one whose legacy was actually one dollar less valuable. This method is applied throughout the grades."
>
> *Magoun* vs. *Illinois Trust & Savings Bank,* 170 U. S. 283, 299.

> "The inequalities charged upon the statute, if there is an intestacy, are all inequalities in the amounts that beneficiaries might receive in case

of estates of different values, or different proportions for the real and personal estate, or of different numbers of recipients; or if there is a will affecting legatees. *As to the inequalities in case of a will, they will be taken to be contemplated by the testator. He knows the law and the consequences of the disposition that he makes.* As to intestate successors, the tax is not imposed upon them but precedes them, and the fact that they may receive less or different sums because of the statutes does not concern the United States."

New York Trust Company vs. *Eisner,* 256 U. S. 345, 349.

The section does not violate the federal constitutional provision guaranteeing all persons equal protection of the laws.

We have weighed the contents of this contention and are unable to find anything of value. The California Inheritance Tax Law, in its operation and effect, affords to all who come under its jurisdiction equal rights. All estates are granted the same privileges and have the same conditions imposed upon them under the act, and in taxing estates which are of sufficient size to be subjected under the federal act to the payment of a tax, we deny to all estates, where the decedent died between July 27, 1917, and August 2, 1921, a deduction on account of the federal tax.

The legislature has determined that it is in the public interest that this tax shall be imposed upon the inheritances which exceed five hundred dollars in

value. There is no constitutional requirement that it shall be imposed upon every inheritance, and the judgment of the legislature in that respect is not open to review by the courts.

Estate of Wilmerding, 117 Cal. 281, 287.

Mr. Justice Brewer in his dissenting opinion in the case of *Magoun* vs. *Illinois Trust & Savings Bank,* at page 301, used this significant language:

> "Of course absolute equality is not attainable, and the fact that a law, whether tax law or other, works inequality in its actual operation, does not prove its unconstitutionality."

Many states exempt from inheritance taxes only such property bequeathed for charitable or educational purposes as shall be utilized within its borders. Such enactments are not unreasonable or arbitrary classifications. Also the right of the legislature to impose the tax includes the right to select the property upon which it shall be imposed. For example, in the instant case the legislature could have raised the rates of tax to obtain added needed revenue, or reduced the exemption, or denied deductions, any one of which would have obtained the same result.

Further, at page 300, Mr. Justice McKenna, in *Magoun* vs. *Illinois Trust & Sevings Bank,* referring to the Illinois inheritance tax act, said:

> "But neither case can be said to be contrary to the rule of equality of the fourteenth amendment. That rule does not require, as we have seen, exact equality of taxation. It only requires that the

law imposing it shall operate on all alike under the same circumstances. The tax is not on money; *it is on the right to inherit;* and hence a condition of inheritance, *and it may be graded according to the value of that inheritance.* The condition is not arbitrary because it is determined by that value; it is not unequal in operation because it does not levy the same percentage on every dollar; does not fail to treat 'all alike under like circumstances and conditions, both in the privilege conferred and the liabilities imposed.' * * *

This court is not a harbor in which can be found a refuge from ill-advised, unequal and oppressive state legislation."

And he said in another case:

"It is hardly necessary to say that hardship, impolicy or injustice of state laws is not necessarily an objection to their constitutional validity."

For the State of California to do the common thing and disallow as a deduction taxes paid by reason of the federal estate tax act, can not be said to be capricious or an unjust or unequal burden on inheritance, nor is the selection of the estates upon which this attempted burden must rest an arbitrary or unreasonable classification. In this connection Mr. Justice McKenna said, at page 294, in the case of *Magoun* vs. *Illinois Trust & Savings Bank*:

"In other words, the state may distinguish, select and classify objects of legislation, and necessarily this power must have a wide range of discretion. It is not without limitation, of

course. Clear and hostile discriminations against particular persons and classes, especially such as are of unusual character, unknown to the practice of our governments, might be obnoxious to the constitutional prohibition."

The section does not violate the inhibition of the federal constitution against depriving persons of property without due process of law, nor does it indirectly attempt to subject to state taxation one of the federal revenues, nor does it interfere with the power of congress to levy and collect taxes.

The constitutionality of inheritance taxation has been declared not only by this court in several instances, but also by the highest courts of many of the states. The principles upon which this tax is based are explained in *United States* vs. *Perkins,* 163 U. S. 625, 628, and *In re Wilmerding,* 117 Cal. 281.

The bases for sustaining the tax are indicated by Mr. Justice McKenna in the court's opinion, *Magoun* vs. *Illinois Trust & Savings Bank.*

"The effect of the legislation under consideration has been determined by this court, and the Court of Errors, in a series of cases in which its legality was attacked from various aspects, with the result of sustaining it as a legislative effort to impose a succession as contradistinguished from a property tax. It is further deductible from these decisions that this legislative power, when not exerted in an arbitrary or capricious manner, or in disregard of fundamental rights, does not contravene any inhibition intended to

secure equality of right, contained in the provisions of the federal or state constitutions."
Maxwell vs. *Edwards,* 99 Atl. 138.

Under our constitutional system both the national and the state governments, moving in their respective orbits, have a common authority to tax many and diverse objects, but this does not cause the exercise of its lawful attributes by one to be a curtailment of the power of government of the other, for if it did, there would practically be an end to the dual system of government which the constitution established.

It can not be said that the State of California is taxing property of the United States. The United States is not a party to this proceeding and we are not sure that such a collateral contention could be maintained.

"This, therefore, is not a tax upon the property itself, but is merely the price exacted by the state for the privilege accorded in permitting property so situated to be transferred by will or by descent or distribution. We think that it follows from this that the act in question is not open to the objection that it is an attempt to tax the property of the United States, since the tax is imposed upon the legacy before it reaches the hands of the government. The legacy becomes the property of the United States only after it has suffered a diminution to the amount of the tax, and it is only upon this condition that the legislature assents to a bequest of it."

United States vs. *Perkins,* 163 U. S. 628, 629, 630;

Campbell vs. *California,* 200 U. S. 87, 94.

The contention that our failure to deduct the federal tax is a taking of property contrary to the provisions of the fourteenth amendment to the federal constitution, and compels the payment of a tax on property which never belonged to the distributee or heir, is answered by the case of *Maxwell* vs. *Edwards,* 99 Atl. 138.

> "Nothing in the fourteenth amendment imposes any ironclad rule upon the states with respect to their internal taxation, or prevents them from imposing double taxation, or any other form of unequal taxation, so long as the inequality is not based upon arbitrary distinctions.
>
> The never-ending aim of popular government and the age-long dream of the political economists have been the evolution of a golden rule productive of equality of taxation.
>
> It is a matter of common experience that absolute equality in the imposition of a tax is not attainable."

To a similar effect this honorable court said:

> "The validity of the tax must be determined by the laws of New York. The *fourteenth amendment* does not diminish the taxing power of the state, but only requires that in its exercise the citizen must be afforded an opportunity to be heard on all questions of liability and value, and shall not, by arbitrary and discriminatory provisions, be denied equal protection. It does not

deprive the state of the power to select the *subjects of taxation.* But it does not follow that because it can tax any transfer (*Hatch vs. Reardon,* 204 U. S. 152, 159), that it must tax all transfers, or *that all must be treated alike.*"

Keeney vs. *New York,* 222 U. S. 525, 535.

Mr. Chief Justice Fuller, in *Giozza* vs. *Tiernan,* 148 U. S. 657, said:

"The fourteenth amendment was not intended to compel the state to adopt an iron rule of equal taxation. The range of the state's power was expressed by Mr. Justice Bradley, as follows: 'It may, if it chooses, exempt certain classes of property from any taxation at all, such as churches, libraries, and the property of charitable institutions. It may impose different specific taxes upon different trades and professions, and may vary the rates of excise upon various products; it may tax real estate and personal property in a different manner; it may tax visible property only, and not tax securities for payment of money; *it may allow deductions for indebtedness, or not allow them.* All such regulations, and those of like character, so long as they proceed within reasonable limits and general usage, are within the discretion of the state legislature, or the people of the state in framing their constitution.' "

And so Mr. Justice Miller, speaking for the court in *Davidson* vs. *New Orleans,* 96 U. S. 97, said:

"The federal constitution imposes no restraints on the state in regard to unequal taxation."

An examination of the brief of plaintiffs in error does not disclose a single case wherein a constitutional attack on an inheritance tax statute by reason of the failure to determine the federal tax or a tax due another sovereign as a deduction is sustained. The question of deducting the federal estate tax is not a new one. It has been raised, as we have pointed out, in many state courts, and always has been dealt with as a problem of construing the particular statute. The state courts have uniformly brushed aside the constitutional objections. When deduction of the federal tax has been allowed it has been on the ground that the legislature intended it to be allowed, and when not allowed, as in the instant case, it has been because the statute under consideration as construed by the court did not provide for such allowance.

> "It is clear that the act of 1919 did not impose a tax on property, but requires payment to be made from the estate of a decedent for the right of succession or the privilege of receiving at death the property possessed by a decedent. * * * This is plain and unambiguous language, holding that the federal tax should not be deducted in determining the amount of the inheritance tax, and, since there is no constitutional provision forbidding this, we must enforce it as written."
>
> *Kirkpatrick's Estate,* 275 Pa. 271.

The section does not violate the state constitutional inhibition against passing of local or special laws changing the law of descent or succession.

An examination of the act itself indicates the weakness of this attack. Nowhere in the provision do we find the least scintilla of an intimation by word, legislative intent or otherwise, that the same is to be considered a statute of descent or succession. Ordinarily, if we are seeking out the statutes of descent and distribution, we confine ourselves to an examination of that portion of the Civil Code dealing with this particular subject, commonly known and designated as title VII, part IV, of the Civil Code.

> "Neither the heirs, legatees, or creditors pay the penalty, but the estate, hence, it is not an exaction laid upon persons innocent of the failure to pay this tax and does not deprive them of their property for they never owned the part so paid any more than they could be said to own the part which went to pay accrued taxes. The plaintiffs say this penalty is confiscation of property, but we see in it nothing more than a reasonable regulation to secure the payment of the public taxes."
> *Bankers' Trust Co.* vs. *State*, 114 Atl. 108.

> "As to the several sections of the state constitution referred to in the foregoing objections, it must be held that these taxes upon the privilege of testamentary transmission and succession, since they are not property taxes can not be held subject to the limitations placed by the constitution upon property taxes."

Estate of Watkinson, 217 Pac. 1073;
In re Frick's Estate, 121 Atl. (Pa.) 35, 39;
In re Sanford's Estate, 175 N. W. 506;
In re Kirkpatrick's Estate, 275 Pa. 271.

A tax on the privilege of transmitting property has some features of a tax regulating testamentary disposition. Today in California we find a regulatory tax on nearly every avenue of endeavor, and the constitutionality of such a levy has been sustained innumerable times by our highest court.

> "The power of the state to regulate the tenure of real property within her limits, and the modes of its acquisition and transfer, and the rules of its descent, and the extent to which a testamentary disposition of it may be exercised by its owner, is undoubted. It is an established principle of law, everywhere recognized, arising from the necessity of the case, that the disposition of immovable property, whether by deed, descent or any other mode, is exclusively subject to the government within whose jurisdiction the property is situated."
>
> *United States* vs. *Fox,* 94 U. S. 315, 320.

Conclusion.

Section 203 of the revenue act of September 8, 1916, provided that, for the purpose of the federal estate tax, the value of the net estate should be determined by making certain deductions, including such other charges against the estate as are allowed by the laws of the jurisdiction. By reason of this provision, coupled with the express declaration in the

1917 California "Inheritance Tax Act" exempting one-half of the community property which goes to the widow on the death of the husband we find the court in the case of *Wardell* vs. *Blum,* 276 Fed. 226, 227, concluding:

> "How is that interest to be determined? Manifestly we think, by the law of the state where the property is situate. In the present instance the law of that state is declared by the statute enacted in 1917, providing that so far as state inheritance taxes are concerned, the wife of a decedent acquires upon his death, one-half of the community property, * * *."

Also in this connection in the opinion of the Honorable Harlan F. Stone, Attorney General, to the Honorable, The Secretary of the Treasury, dated October 9, 1924, on the question of the recognition of a vested community interest in a California wife or widow for federal estate tax purposes said at page 5:

> "It may be conceded that questions of title to property and the incidents thereof, questions of devise, inheritance and succession are questions primarily of state law, and that when those questions arise in a federal court, the law of the state should be followed. * * *
>
> * * * In passing upon questions of state law of this type, it is the duty of the federal court to refer to the statutes and decisions of the state for the purpose of ascertaining what the law of the state is, and ordinarily federal courts follow and apply the state law as defined by the judicial decisions of the state courts."

At page 14 of the opinion we find:

> "* * * a study of the situation * * * and considering those principles which must govern the incidence of a federal taxing statute upon a subject matter which is the creation of state law."

Defendant in error, therefore contends that the power of the federal government to collect its estate tax must be confined to the regulations prescribed for the privilege of succession by the states. The entrance of the federal government into this taxing field, enjoyed for more than thirty years by the State of California, can not diminish or destroy the powers and rights heretofore enjoyed by this state. Under our dual system of government, in instances of this character, the jurisdiction of the federal government not being concurrent with that of the state, the paramount rights can not be with the federal government.

We have heretofore made reference to the case of *Snyder* vs. *Bettman*, which is the converse of *U. S.* vs. *Perkins* and *Plummer* vs. *Coler*. In the *Perkins* case a tax was validated on a bequest to the United States, while in the *Plummer* case a bequest consisting wholly of United States bonds was subjected to tax. The case of *Snyder* vs. *Bettman* validated a tax upon a bequest to a municipality and the authorities hold that municipal bonds stand in no different position from money payable to a state and the estate tax being the antithesis of a direct tax, the transfer was taxable.

In *New York Trust Company* vs. *Eisner*, question was raised to the federal estate tax on the ground

that it was a direct tax and, therefore, invalid because not apportioned, and on the further ground that if it was an indirect or transfer tax it was cast upon the transfer while the latter was being effectuated by the state, and was consequently an interference by the federal government with state processes. Those questioning its validity laid special emphasis on the fact that the privilege of transfer is created by state laws exclusively, which was not doubted. If a tax by the federal government on a privilege created exclusively by a state, such tax accruing at the instant of transfer, is not an unconstitutional interference with state processes, how can a similar tax imposed by the jurisdiction which itself creates the privilege be an unconstitutional interference with federal processes?

Sacramento, California,
January 31, 1925.

Respectfully submitted.

RALPH W. SMITH,
Inheritance Tax Attorney
for California,
Attorney for Defendant in Error.

WESLEY E. MARTEN, Sacramento,
DION R. HOLM, San Francisco,
ARTHUR H. BROUILLET, San Francisco,
ERWIN P. WERNER, Los Angeles,
ADRIAN C. STANTON, Los Angeles,
Of Counsel.